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In the
Supreme Court of the United States

OCTOBER TERM 1960
No. 283

FIRST NATIONAL BANK OF CHIPPEWA FALLS, A CORPORATION
Plaintiff and Petitioner

vs.

CHARLES HENNEMAN COMPANY, A CORPORATION
Defendant

ANDY JOHNSON AND VIOLET JOHNSON
Defendants and Petitioners

UNITED STATES OF AMERICA
Defendant and Respondent

FRANK HAUPTMANN, AS RECEIVER OF CHARLES HENNEMAN COMPANY
Defendant

CHIPPEWA COUNTY
Defendant and Respondent

BRIEF OF CHIPPEWA COUNTY OPPOSING PETITION FOR WRIT OF CERTIORARI

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STATEMENT OF THE CASE
(Corrections and Additions)

On page 5 of the Petition it is stated "An itemization of taxes and interest due as of January 20, 1959, is shown at Appendix III, p. 22a." Evidently this is an error. The

taxes and interest to the end of July, 1960, are shown at pages 29a and 30a of Appendix IV to the petition.

On page 6 of the Petition there is a statement that the property was sold in the insolvency proceeding. It is not stated, but the fact is, that all of the parties stipulated for sale of the real estate and that the proceeds be substituted for the land (Record 99 thru 102) and the court entered an order directing sale (Record 103 and 104). The sale took place in 1955 (Petitioner's Appendix I, Opinion of Wisconsin Supreme Court, page 10a).

On page 7 of the Petition it is stated that the trial court "was of the opinion; that the county's taxes were unlawful and uncollectible." This goes too far. The trial court said that the county would receive no part of the proceeds of sale, but it did not say that the real estate taxes were unlawful nor imply that the real estate was immune to state taxation because the United States had a lien (Opinion of lower court, Petitioner's Appendix I, pages 1a to 3a).

ARGUMENT

I.

The petitioners are now asking the court to hold that mortgaged real estate becomes immune to state taxes when a federal lien is filed which exceeds the value of all of the taxpayer's property, both real and personal.

The first question is stated by the petitioners as follows (on page 2 of Petitioner's brief):

> "In those cases where a federal income tax lien exceeds the value of the taxpayer's property, and where the property is subject to mortgages which are prior to the federal lien, may state or local government, after the federal lien is filed, continue to levy and col-

lect a real estate tax on the full market value of the property?"

The federal lien attaches to all of the property of the taxpayer everywhere, because *26 U. S. C.* 3670 provides: "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount * * * shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." If mortgaged property is immune when an "encompassing" federal lien is filed, the local assessor can not decide whether any single parcel of real estate is immune to taxation until he determines (1) whether the property is mortgaged, (2) whether a federal lien has been filed, (3) how much is due on the federal lien, and (4) whether such amount due is greater or less than the total value of all of the taxpayer's property everywhere in the United States or the territories. If the assessor, after a complete audit of all of the property of the taxpayer, decides that its value is greater than the amount of the lien, the taxpayer must then repeat the whole process in order to know whether to pay the tax.

In the present case, we do not know what the debtor's property was worth in 1951 when the first disputed tax was assessed. Nor do we know what it was worth in 1952, 1953, or 1954. We only know what price the debtor's real estate brought when it was sold in 1955 pursuant to stipulation in this action and in the receivership (Record page 100). The petitioners are asking this Court to hold that the 1951, 1952, 1953, and 1954 taxes were "invalid" because in 1955 it turned out that the real estate sold for less than the amount of the government lien. It appears that the new rule of law to be announced by the Court must take into account many factors peculiar to the present case,

and the precedent thus established would have to be stated like an algebraic formula.

The petitioners contend that their first question was presented both to the trial court and the Supreme Court of Wisconsin. But the record does not contain any proof of values in 1951. Without such proof, how can the Court in 1960 say that the property was immune from real estate taxes in 1951, 1952, 1953 and 1954? Or do the petitioners ask the Court to hold that all of the real estate taxes of Wisconsin for those years were invalid because the tax statute was imperfectly drawn? Do they contend that a state tax law must contain provisions safeguarding the federal revenues in those situations where a federal lien is filed against mortgaged property?

Restated in the circumstances of the present case, the contention of the petitioners amounts to this: If the value of a debtor's real estate, as determined by voluntary sale in 1955, was less than the amount of a federal lien which attached to all of the debtor's property in 1951, real estate taxes assessed against the debtor's real estate in 1951, 1952, 1953, and 1954 were invalid because the real estate was actually property of the United States and as such immune from state taxes.

On page 16 of their brief, the petitioners "concede that even the most careful reading of the opinion of the Wisconsin Supreme Court would not indicate that any of the questions here raised had been presented to it." But they contend that the state courts in effect decided these questions, because the points were mentioned in the course of the litigation, and they quote from their briefs to demonstrate that similar questions were called to the attention of the state courts.

For example, in their trial brief Andy and Violet Johnson said (Petitioner's Appendix III at pages 23a and 24a):

> "This lawsuit demonstrates very clearly that, after deducting the mortgagees' share of the real estate, the balance of the real estate belongs to the United States. The United States does not have title to the real estate, because it has not foreclosed its lien; and, therefore, technically the local municipality might still have some legal basis for assessing real estate taxes; but, it does not have any equitable basis for requiring the mortgagees to pay taxes on the entire assessed valuation."

Even though the rule adopted in the state courts has an inequitable effect on these mortgagees, the United States court should not interfere, because, as the Court stated in *Orvis v. Powell* (1878), 98 U. S. 176, 25 L. ed. 238, at page 239 of 25 L. ed.:

> "As regards the question raised by the first of these assignments, we are relieved of all discussion of what is the true, equitable rule on the subject, because we consider that when such rule is adopted it is, within the decisions of this court, a rule of property affecting the title to real estate, and as such is to be governed, in its application in this court, by the law of the State where the land lies."

A reading of the entire record here will show that this is a desperate, last ditch attack upon the validity of a tax. The briefs will show that the petitioners wondered, speculated, queried, and doubted, but never cited cases to sustain their attack on the validity of the real estate taxes. In fact, both of the petitioners stipulated that the "invalid" 1955 tax should be prorated and paid from the sale proceeds (Record page 100), and the petitioners Johnson offered to pay all of the "invalid" taxes if they could be assured that such payment would displace the federal lien (Record page 224-11, Appendix 23a).

The petitioners' argument on the validity or invalidity of the real estate tax is set forth, without citation of cases, on page 19 of their petition, as follows:

> "Since the federally owned share is not taxable by the state, the state cannot continue to levy a tax on the whole of the market value of the property, and collect it from the mortgagees' interest.
>
> "The due process clause, and the equal protection clause both limit the state's power to tax, to a tax on the mortgagees' interest.
>
> "Under Wisconsin law, real estate is assessed to the owner, not split up into mortgagor and mortgagee interests. Since the United States had become the owner of the property, no tax could be levied or collected."

These assertions of the petitioners should be supported by decisions of this Court. The respondent has found two cases where similar attacks were made upon the validity of state tax laws purporting to assess the full value of all interests in real estate. Although in each case the United States had an interest in the real estate, it was nevertheless held that the state tax law was valid. These cases will be discussed in the next section of this brief.

II.

This court has held that the full value of all interests in real estate may be assessed by the states even though legal title is in the United States, so long as no attempt is made to enforce the tax against the interest of the United States.

The petitioners close their eyes to the fact that the United States had only a lien against this real estate, and did not

have legal title when the real estate taxes in question were levied. The taxpayer's property does not become property of the United States when the lien is filed. The federal tax liability may be paid or compromised. But in effect the petitioners contend that the filing of an "encompassing" lien amounts to a confiscation or expropriation of the taxpayer's property.

If the state may tax the full value of real estate to the equitable owners despite the fact that legal title is in the United States, surely the state may tax the full value to the legal owners despite the fact that the United States has a lien. In two cases this Court has held that states may tax the interests of purchasers under land contracts where the legal title is in an agency of the United States.

In *New Brunswick v. United States* (1928), 276 U. S. 547, 72 L. ed. 693, 48 S. Ct. 371, it appeared that legal title to the real estate was held by an agency of the United States, namely, the United States Housing Corporation, but the purchasers had made enough payments so that they were entitled to a deed upon executing notes and mortgages for the balance of the purchase price. Real estate taxes assessed after the sale were not paid and tax sale was threatened. This Court said, at page 698 of 72 L. ed.:

> "Under the provisions of the New Jersey law the taxes assessed to the purchasers, as equitable owners, rest upon the entire lots; including not only the interests of the purchasers as equitable owners, but the interest of the corporation retained and held as security for the payment of the unpaid purchase moneys; no distinction being made under that law between the interest of the owners and that of mortgagees or lienors. We see no reason, however, if the New Jersey law permits, why the city may not assess taxes against the purchasers upon the entire value of the lots and

> enforce collection thereof by sale of their interests in the property. With that the corporation and the United States have no concern. But it is plain, under the doctrine of the Clallam County case, that the city is without authority to enforce the collection of the taxes thus assessed against the purchasers by a sale of the interest in the lots which was retained and held by the corporation as security for the payment of the unpaid purchase money, whether as an incident to the retention of the legal title or as a reserved lien or as a contract right to mortgages. That interest, being held by the corporation for the benefit of the United States is paramount to the taxing power of the state and cannot be subjected by the city to sale for taxes."

The *New Brunswick* case was cited and followed in *S.R.A. Inc. v. The State of Minnesota* (1945), 327 U. S. 558, 90 L. ed. 851, 66 S. Ct. 749, in which this Court held (headnote 12):

> "A state may constitutionally tax the interest of a purchaser, under an executory contract, of land to which the United States retains legal title, so long as the rights of the United States remain unaffected."

The Minnesota tax law in question was like the Wisconsin law in that the real estate taxes were assessed on the parcel of land as a "unitary item" including all rights and privileges.

These decisions have settled the question the petitioners now attempt to raise as to the validity of a state tax upon real estate to which a federal tax lien has attached. If the land may be taxed where legal title is in the United States, certainly it may be taxed where legal title is in a private corporation and the United States has only a lien which has attached to all of the property of the private corporation. If the Wisconsin Supreme Court failed to discuss this

question, it may be assumed that it did so because the petitioners' arguments had failed to create doubt as to the validity of the tax. The entire real estate tax system of the State of Wisconsin should not be held invalid because the tax statute makes no mention of the effect the tax will have upon a prior federal tax lien.

Under the petitioners' view of the law, it would be to every taxpayer's advantage to have a federal tax lien attach to his real estate, making it immune to local real estate taxes. The taxpayer could afford a modest federal lien if he owned many parcels of real estate scattered over the country, because a modest lien would be large enough to "encompass" each parcel separately and render it immune to local taxes, even though such lien were very small in relation to all of the property of the taxpayer.

The immunity of federal property from state taxes is expressly recognized by Section 1.04, *Wisconsin Statutes*, which provides as follows:

> "1.04 *United States sites exempt from taxation.* Upon full compliance by the United States with the requirements of sections 1.02 and 1.03, relating to the acquisition of any place or tract within the state the governor shall execute in duplicate, under the great seal, a certificate of such consent given and of such compliance with said sections, one of which shall be delivered to such officer of the United States and the other filed with the secretary of state. Such certificate shall be sufficient evidence of such consent of the legislature and of such compliance with the conditions specified. All such places and tracts after such acquisition and while owned by the United States, shall be and remain exempt from all taxation and assessment by authority of the state."

In the present case the Wisconsin courts have expressly recognized that the rights of the United States may not be

affected by enforcement of the state tax. The proceeds of sale have been divided, and the entire share of the United States has been set aside for it. The state tax has been enforced only as against the interests of the petitioners. Neither of the petitioners has any standing as an agency or instrumentality of the United States, and therefore neither of the petitioners may claim immunity from enforcement of the state tax.

III.

In the trial court, the United States Attorney raised a federal question by contending that the federal lien displaced the mortgages under Section 3466 of the Revised Statutes (because the debtor was insolvent), but this question was not considered by the Supreme Court because in its Supreme Court brief the United States expressly abandoned this claim.

It may be helpful in considering the present case to know that the United States Attorney modified his contentions as the case progressed. In the trial court the United States claimed that the federal tax lien displaced the mortgages because the debtor was insolvent. Section 3466 of the Revised Statutes, *31 U. S. C. A.* 191, was relied upon in pressing this claim (Memorandum Brief of United States, Record pages 159 through 197, at page 172). Because the attention of the trial court was focused upon this extreme claim of the United States, the trial court failed to recognize that state law must be applied to the question of priority as between the mortgages and subsequent real estate taxes. However, the trial court discarded the claim of absolute priority for the federal tax lien (Decision of trial court, Record pages 114 through 115, at page 114).

The claim of absolute priority of the United States under

Section 3466 of the Revised Statutes, which was vigorously pressed in the trial court, dropped from the case in the Supreme Court. In his Supreme Court brief, the United States Attorney said (Record pages 448 to 476, at page 463):

> "The United States has abandoned its claim below that it is entitled to priority under Section 3466 of the Revised Statutes, supra, because of the taxpayer's act of insolvency, over the mortgagees."

IV.

The only federal questions remaining for the Wisconsin Supreme Court were (1) priority as between the federal lien and prior mortgages, and (2) priority as between the federal lien and subsequent real estate taxes.

After the United States abandoned its claim of absolute priority under the insolvency statute, there were only two federal questions to be answered by the Wisconsin Supreme Court. These were (1) priority as between the federal lien and prior mortgages and (2) priority as between the federal lien and the subsequent real estate taxes. Both questions were correctly answered by the trial court and the Wisconsin Supreme Court.

After these questions were answered, there remained one more question for the Wisconsin courts, namely, priority as between the mortgages and the real estate taxes. But that was not a federal question. Priority as between mortgages and real estate taxes is a matter of state law, in which federal courts should not interfere.

In studying federal lien and priority cases, counsel has not found one decision of the United States Supreme Court ruling on priority as between a mortgage lien and a state tax lien. The decisions are confined to questions of priority

as between federal liens and other liens. As the Court said in *United States v. New Britain* (1954), 347 U. S. 81, 98 L. ed. 520, 74 S. Ct. 367, at page 527 of 98 L. ed., the question of priority as between mortgages and state taxes is "a matter of state law."

V.

Both the trial court and the Supreme Court held that (1) under Section 3672 of the Code, the mortgages were superior to the subsequently filed federal lien, and (2) under federal case law, the federal lien was superior to real estate taxes assessed after the federal lien attached.

Section 3672 of the Code made it clear that the interests of the mortgagees were preserved as against the federal lien, and both the trial court and Wisconsin Supreme Court so decided. This question having been correctly answered, there remained only the question of priority as between the federal tax lien and the subsequent real estate taxes. In accordance with the ruling in *Michigan v. United States* (1942), 317 U. S. 338, 87 L. ed. 312, 63 S. Ct. 302, both courts held that the local taxes could not displace the federal lien. The petitioners do not complain of the state court answers to these federal questions. Instead, they attempt to set up additional questions which may now be answered in their favor.

VI.

The trial court's error in applying federal law to determine priority as between the mortgages and the real estate taxes was corrected by the Wisconsin Supreme Court, which held that priority as between the mortgages and the real estate taxes was a matter of state law.

As stated above, the trial court held that Section 3672 of the Internal Revenue Code (*26 U. S. C.* 3672) preserves the rights of prior mortgagees not only *as against the federal tax lien*, but also as against subsequent real estate taxes (Decision of trial court, Record pages 108 through 115, at page 114), saying:

> "Thereupon the question arises whether a priority for payment of real estate taxes arises as against the mortgage interests. If it does, the priority to the mortgages under the statute is largely absorbed * * * It is not apparent how in the circumstances present the rights of lien claimants which are completely overridden by the encompassing size of the federal tax lien can in effect be revived. Without a mortgage on these premises there is nothing left for local real estate taxes, and accordingly where there is such a mortgage there is nothing after the mortgage to which such taxes can attach. It is the property, not the mortgage, which is taxable, and the federal lien has taken that."

The foregoing quotation shows that the trial court failed to limit the effect of the federal priority statutes to the federal questions involved in the case. Instead, the trial court attempted to solve the state priority problem by applying the federal priority rule. This was error. As this Court said in *United States v. Marxen* (1938), 307 U. S. 200, 83 L. ed. 1222, 59 S. Ct. 811, at pages 1227 and 1228:

> "Priority has been secured to the United States in varying language throughout its history. The tendency has been to interpret these provisions liberally to secure the advantage sought by Congress. * * * But this principle of construction is subject to the limitation that the generality of the language of the section is restricted by the purpose to grant priority to the United States only."

The trial court's error in applying federal law to the priority problem of the mortgagees versus the county was corrected by the Supreme Court of Wisconsin, which held that priority as between the mortgages and the county was a matter of state law (Record page 243, Petitioner's Appendix 13a).

VII.

Since the state court decided the federal question in accordance with the decision in United States v. New Britain, certiorari should be denied.

In its brief for the Wisconsin Supreme Court, the county quoted the entire opinion in *United States v. New Britain* (1954), 347 U. S. 81, 98 L. ed. 520, 74 S. Ct. 367, with particular emphasis upon the following language (at page 527 of 98 L. ed.):

> "The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of state law. But as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the federal lien."

The Wisconsin Supreme Court carefully followed the *New Britain* decision. It held that priority as between the real estate taxes and the mortgagees was a matter of state

law. It applied the rule of "first in time, first in right" as between the federal lien and the real estate taxes, and applied Sec. 3672 of the Internal Revenue Code, *26 U. S. C. A.* 3672, as between the mortgages and the federal lien (Opinion of Wisconsin Supreme Court, Petitioner's Appendix I, pages 3a to 13a, at page 12a).

Since *United States v. New Britain* was carefully followed in deciding the federal questions presented by the record, it does not now appear that a federal question has been decided in a way "probably not in accord with applicable decisions of the Supreme Court of the United States." The petition for certiorari should therefore be denied.

VIII.

Because the petitioners did not pay the subsequent real estate taxes, this case does not properly present the question whether such payment could enlarge their mortgage interests at the expense of the federal lien.

In *United States v. New Britain* (1954), 347 U. S. 81, 98 L. ed. 520, 74 S. Ct. 367, there was a priority contest involving two mortgages, a judgment of record, a federal tax lien, and real estate taxes and water rent liens, some of which had attached before the federal lien and some after. The State of Connecticut contended that the mortgagee could have paid the delinquent real estate taxes and water rents, with the amount so paid becoming part of the mortgage debt secured by the mortgage lien, thereby pushing aside the federal tax lien pursuant to Section 3672. The Supreme Court of the United States declined to say whether the federal lien could be displaced by such payment, explaining in Footnote 12, "We need not now pass upon the merits of this suggestion since the situation is not presented by the record in this case."

The same is true in the present case. The record shows that the mortgagees did not avail themselves of their right under state law to pay the taxes and add them to their mortgages. In their brief the petitioners explain that it would be unrealistic and unreasonable to expect the mortgagees to risk the further sum of $15,000 in order to be entitled to raise this question. But their study of the Wisconsin cases on the effect of the real estate tax should have warned them that these taxes were a threat to their mortgage security. There is nothing new about the proposition that a mortgagee must either (1) compel the mortgagor to pay the real estate tax, (2) pay it himself, or (3) foreclose before the tax eats up his security.

In *Aberg v. Moe* (1929), 198 Wis. 349, 224 N. W. 132, the Wisconsin court said, at page 359:

> "No doubt the legislature might empower the assessor to assess the leasehold interest against the lessees and so divide up the property for the purposes of taxation. That, however, has never been the policy of our law so far as we know except for a brief period when the state undertook to tax the respective interests of the mortgagor and mortgagee separately. The entire property, including all interests in it, is assessed to the owner of the property as defined in the statute, and the right of every person claiming any interest in the property subordinate to the fee, whether under lease, contract, or otherwise, is extinguished if the property be sold in the exercise of the taxing power."

The fact is that the petitioners are complaining of a loss of security which resulted not from uncertainty as to the meaning of Section 3672, but from their own neglect to act promptly after they learned of the filing of a federal lien.

CONCLUSION

We therefore respectfully submit that the federal questions in this case have been correctly answered in accordance with settled rules of law, and that the petition for certiorari should be denied.

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